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In the

Supreme Court of the United States

OCTOBER TERM, 1972

ROSS HILLS MEMORIAL PARK ASSOCIATION,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Claims

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Brief Amicus Curiae on Behalf of American Cemetery Association

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This brief in support of the petition for a writ of certiorari is submitted with the written consent of counsel to both parties filed with the Clerk of the Court.

INTEREST OF THE AMICUS CURIAE

The American Cemetery Association, founded in 1887, is a national trade association of cemeterians consisting of approximately 1100 members. Its membership represents more than 650 cemeteries, two-thirds of them nonprofit organizations, situated in every state and ranging from large metropolitan parks to small traditional institutions located in rural communities. Since its organization, the Association has served its members with information and advice concerning the operation, maintenance and improvement of American cemeteries and has in other ways promoted the interest of its membership.

The decision of the Court of Claims is of immediate and direct concern to the Association's members. The Court held that the widely used and only feasible method by which nonprofit cemeteries can acquire land, i.e., in exchange for a percentage of the future gross receipts from sales of grave lots, is incompatible with the cemeteries' exemption from tax under section 501 (c)(13) of the Internal Revenue Code of 1954. The decision undoubtedly will be used by the Commissioner to overturn the tax-exempt status of nonprofit cemeteries which have entered into deferred payment contracts of the kind now under attack. And nearly all of them have.

Until now, a non-profit cemetery repaying the cost of its land out of the receipts from sales of lots was considered exempt and no part of its income taxable. The Court of Claims would not only remove the cemetery's exemption, but, by treating the payments to the sellers as "dividends", would preclude their deduction as cost of the lots sold.[1] This new rule would thus abruptly generate a large amount of federal income tax liability for organizations which have customarily been operated to break even. When state income taxes and property taxes (generated by loss of exempt

1. The Court of Claims treats the land sellers as "investors" who transfer property to a taxable corporation in exchange for an equity interest. The transfer is tax free under section 351 of the Int. Rev. Code of 1954, with a carry-over of basis for the land. This basis for raw land is normally low so that the taxable income is practically gross receipts.

status) are added and the revocation of tax-exempt status is made effective for back years, the total tax liability for the minimum three years[2] will overwhelm a nonprofit cemetery which by the very principle of operating not for profit has no reserves built up. The burden will be cast on the cemetery—not on any "stockholders" or "promoters"—and the taxes will be paid, if at all, by reducing the standards of care and maintenance of the institution.

The Association is equally concerned with the long range implications of the Court of Claims' decision. Cemeteries require a large initial dedication of land. In the case of nonprofit cemeteries, such land can only be paid for very slowly over a long period of time. Because cemetery land does not provide commercial security as collateral,[3] the establishment of nonprofit cemeteries and the expansion of existing ones have in the past depended, and depend today, on the cemetery's right to use a portion of the sale proceeds of its grave lots to pay for the land over a period of years. If utilization of this source of funds is declared incompatible with exemption from tax, nonprofit cemeteries may well become extinct, and the progress which has been made in establishing and maintaining decent, open, well-cared for cemeteries in most American communities will be ended.

ARGUMENT

The Court of Claims held that payments by a nonprofit cemetery to sellers under a deferred contract for the purchase of land constitute inurement of "net earnings" to private individuals in violation of section 501 (c) (13) of the Internal Revenue Code of 1954, regardless of the fairness of the price in terms of the pres-

2. Sections 6501 (g) (2) and 6501 (a), Int. Rev. Code of 1954. Where the Commissioner has exacted "waivers" of the statute of limitations, the liability for back years' taxes can be staggering. Rose Hills faces 12 years of back tax liabilities.

3. Once a few interments have taken place, the land is irretrievably committed to cemetery use. Foreclosure and sale or other procedures customarily relied on for realizing on security are futile, a circumstance well known to banks or other lenders.

ent value of the deferred payments. The decision directly conflicts with the decision of the Court of Appeals for the Second Circuit in *Commissioner v. Kensico Cemetery*, 96 F.2d 594 (2d Cir. 1938), upon which nonprofit cemeteries have relied for thirty-five years; is based on an erroneous understanding of the concept of inurement of net earnings; is inconsistent with this Court's reasoning in *Commissioner v. Brown*, 380 U.S. 563 (1965); and ignores the principle of the protection of good-faith reliance enunciated most recently by this Court in *United States v. Byrum*, 408 U.S. 125 (1972).

1. Commissioner v. Kensico Cemetery

In the *Kensico* case, the Court of Appeals for the Second Circuit held that a nonprofit cemetery did not lose its exemption where it purchased land pursuant to a New York statute authorizing agreements to pay as the purchase price, instead of a fixed sum, "any specified share or portion not exceeding one-half the proceeds of all sales of lots or plots made from such lands." 96 F.2d at 595. The Court expressly found that Kensico Cemetery did *not* effect a distribution of net earnings when it paid for its land in this manner. This case, decided in 1938, recognized the economic exigencies of nonprofit cemeteries and has provided the legal foundation for their *modus operandi* for the past thirty-five years. The decision was followed by the Board of Tax Appeals (now the United States Tax Court) in *Forest Lawn Memorial Park Ass'n., Inc.*, 45 B.T.A. 1091 (1941), and by the Tax Court in *Forest Lawn Memorial Park Ass'n., Inc.*, 5 T.C.M. 738 (1946). In 1946, the Commissioner added further impetus to this type of land purchase arrangement when he acquiesced in the first *Forest Lawn* decision. 1946-2 Cum.Bull. 2.

The result has been that most nonprofit cemeteries have done exactly what Rose Hills did, they relied on what appeared to be a well established view of the law, recognized not only by state legislatures and responsible courts but by the Commissioner

of Internal Revenue himself as an acceptable means of getting underway and operating the cemetery. The contracts which nonprofit cemeteries have entered into to acquire land are by their very nature long-term contracts, predicated on what was thought to be an established rule that such contracts were entirely consistent with exempt status.

2. To Ignore the Present Value of the Sellers' Contract Rights on the Date of the Transfer is Unsound

Twenty-three years after *Kensico* and fifteen years after his acquiescence in *Forest Lawn*, the Commissioner reversed his position in respect of these land acquisition arrangements by nonprofit cemeteries. He withdrew his acquiescence and substituted nonacquiescence in the first *Forest Lawn* decision, 1960-2 Cum. Bull. 8, and promulgated Rev.Rul. 61-137, 1961-2 Cum.Bull. 118. As does the present case, the ruling deals with a contract whereby a cemetery's purchase price for its land is based on a percentage of the price at which the land is later resold by the cemetery. In his revenue ruling, the Commissioner observed that the total payments received under such a contract will ordinarily exceed the reasonable value of the land at the time of its sale to the cemetery by a substantial amount. From this fact alone, and without regard to the *present value* of the deferred payments, the Commissioner concluded that the percentage sale resulted in an unreasonable price and that a cemetery entering into such a contract was not exempt. 1961-2 Cum.Bull. at 120.

Under the Commissioner's theory, now reiterated by the Court of Claims, every contract providing that the seller's price is determined by a percentage of the resale price would cause the buyer's net income to inure to the seller. This theory is patently unsound. In all such cases, the sellers receive payments out of the gross receipts of the business; but this does not answer the question whether these payments constitute the repayment of a debt for land bought and sold on credit or the inurement of "net earnings."

Since payment of legitimate expenses is a necessity, the prohibited inurement must be something above and beyond a legitimate expense or cost of goods of the exempt organization. Just as only *excessive* rentals or *excessive* salaries constitute inurement of net earnings, *Texas Trade School v. Commissioner*, 272 F.2d 168 (5th Cir. 1959), aff'g 30 T.C. 642 (1958); *Mabee Petroleum Corporation v. United States*, 203 F.2d 872 (5th Cir. 1953), so is only the payment of an *excessive* sales price prohibited by the statute. Whether the price is excessive must be determined by comparing, at the time of the transfer, the fair market value of the transferred property with the present value of the contract rights received by the sellers.

For example, total payments under a contract giving the seller 1%, 5% or 30% of the resale price received by a nonprofit cemetery may or may not result in an excessive price to the seller. The factors to be considered are the length of the deferral period and the sales proceeds realized during the deferral period. If the *present value* of these sales proceeds is given no consideration, any judgment that the seller is receiving an excessive price at the cost of the exempt cemetery must remain conjecture.

In sum, the refusal of the Court of Claims to attach any significance to the present value of the sellers' contract rights on the date of the transfer blurs the very issue in the cemetery cases, namely, whether a given percentage arrangement constitutes the prohibited inurement of net earnings by producing an excessive price for the seller.

3. Commissioner v. Brown

The failure to determine the present fair market value is also inconsistent with this Court's views as expressed in *Commissioner v. Brown*, 380 U.S. 563 (1965). The *Brown* case involved the sale of a business in return for a sum payable out of the future earnings of the business. This Court rejected as inconclusive the argument that no sale occurs where there is no risk-shifting and that

there is no risk-shifting because the price to be paid is payable only from the income produced by the thing sold. 380 U.S. at 570. The lack of risk-shifting was held by this Court to be relevant only insofar as it produced an excessive price, 380 U.S. at 573-574, thus leaving *the fairness of the price the ultimate criterion for the sale*. As this Court said:

> "To require a sale for tax purposes to be to a financially responsible buyer who undertakes to pay the purchase price from sources other than the earnings of the assets sold or to make a substantial down payment seems to us at odds with commercial practice and common understanding of what constitutes a sale."
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> * * *
>
> "To accept the Commissioner's definition of sale would have wide ramifications which we are not prepared to visit upon taxpayers, absent congressional guidance in this direction." 380 U.S. at 575.

4. Congress—Not the Court of Claims or the Internal Revenue Service—Should Fashion Any New Rules for Taxation of Nonprofit Cemeteries

Absent Congressional guidance, the Court of Claims is not the proper agency to proclaim a new rule of general application with potentially far-reaching consequences. This Court said only recently, in *United States v. Byrum*, 408 U.S. 125, 135 (1972): "When a principle of taxation requires re-examination, Congress is better equipped than a Court to define precisely the type of conduct which results in tax consequences."

Insofar as the decision overturns a reasonable and necessary business practice of long standing, the cemetery industry should be given an opportunity to be heard.

Insofar as the continued existence of private nonprofit cemeteries is a matter of state and local concern, the appropriate state agencies should be heard and a proper study of the impact of the decision on the operation and maintenance of public burial grounds made. Only the Congress has the power or facilities to conduct these inquiries.

Insofar as the exemption of nonprofit cemeteries from federal income tax is a long established policy of the Congress, any major change of rules should be initiated by the Congress itself. The major changes effected by the Tax Reform Act of 1969 in the law of tax-exempt organizations did not include any change in the rules applicable to exempt cemeteries. It should not be left to the Court of Claims or to the Internal Revenue Service to fashion new rules now.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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